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AUTHOR(S) OF THIS ALERT

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and Members of TICA's
Executive Committee

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TICA OPPOSES MONTANA HOUSE BILL 256 PROPOSING TO EXEMPT TIC TRANSACTIONS FROM STATE SECURITIES LAWS

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On behalf of TICA and its members, Patricia DelRosso, TICA President, appeared at a public hearing held on January 26, 2007 in Helena, Montana before the Montana House Judiciary Committee to oppose House Bill (HB) 256 (the "Bill").

House Bill (HB) 256 was introduced in the Montana Legislature in January 2007. It proposes to exempt from the state's securities laws all tenancies in common or any other undivided interest in real estate between 2 and 35 owners where the real property is subject to a management agreement if, the management agreement permits a majority of the owners to not renew or to terminate the agreement at the earlier of the end of the term of the agreement or 180 days after the date on which the majority of the owners give notice of termination.

The author of HB 256 is Bob Lake who is a licensed real estate professional and also senior Member of the Montana House of Representatives. Proponents of this Bill included Jeff Warr, FOR 1031/Spectrus legal advisor, Al Mansell, past president of the National Association of Realtors (NAR) and former Utah State Senator, and a couple of Montana licensed real estate professionals. The focus of their message was that the Bill was needed to allow compensation to be paid to licensed real estate professionals involved in TIC transactions.

After an introduction of the makeup of TICA, and key historical events that shaped the TIC industry, TICA opposed the Bill based upon the following reasons:

1. The Bill inappropriately eliminates the role of the Montana Securities Commissioner and the investor protections provided by the securities laws. Treating TIC interests as securities protects investors by: a) requiring sponsors and sellers to fully inform investors about the true value of the property, the history of its operations, any prior disciplinary history of promoters, and the risks of the investment, b) requiring that the sellers are licensed as securities agents, c) enabling the Securities Commission to conduct investigations into fraudulent offerings so investors can have confidence in the legitimacy of real estate investments offered by licensed sellers, and d) giving investors the right to sue for redress under the securities laws in the event of fraud.

History instructs that investors need the protection of strong state securities regulation to protect against fraud and overreaching by unscrupulous promoters. State securities laws have been an effective deterrent. They are structured as "seller beware" laws, meaning sellers are required to take affirmative steps to make investors aware of important facts and provide for appropriate remedies to investors when things go wrong, supported by well developed case law. These laws are also designed to increase, and have the effect of increasing, investor confidence – so people will be

more willing to purchase these investments. Moreover, state regulators are well equipped to interdict securities fraud and overreaching. They know it in its hundreds of different forms. They are good at it. In contrast, real estate laws, while providing some important protections, are generally “buyer beware” laws and often these laws are unfriendly to disappointed purchasers. Changing the focus in Montana would be a step down from high regulatory standards for these investments, exposing Montana’s investors to be the prey of those who welcome lower standards, establishing Montana as a haven for fraud in this area. Our Association promotes a high standard in these products and the manner in which they are sold, because we know disappointed investors make for bad markets – something we try to prevent at all costs.

2. The Bill’s principal objective could be achieved by less harmful means. Laws like HB 256 are typically supported by real estate professionals seeking to avoid securities licenses in the handling of TIC transactions. However, that can be achieved without eviscerating Montana’s securities law. Montana’s State Securities Commission can consider and issue a no-action letter permitting licensed real estate professionals to participate in TIC transactions without the necessity of having a securities license. The National Association of Realtors (NAR) in conjunction with the Securities and Exchange Commission (SEC), as well as, various State Securities Administrators, have been considering this course of action. TICA urged the Montana legislators to take no action on HB 256 before this potential compromise is fulfilled.

3. TIC transactions are investments by nature and should be so regulated. While blending elements of real property and investments, TICs decidedly are sold more like investments, than real estate, subject to the anti-fraud authority of government securities agencies. The vast majority of TICs are managed by capable managers and others who oversee the operations of the property without direct participation of the TIC owners. TIC owners have a say in who does the managing and they approve sales and leases, but for the most part, their investment is passive, and they rely on others’ management skills for the success of their investment. It is because the real estate is sold with an investment and management component that the securities laws should apply.

For example: If a banker started a separate business division that was charging fees for separate investment advice, he/she would be subject to the securities laws in addition to being subject to banking laws. If an insurance agent sells mutual funds or variable annuities, he/she would be subject to the securities laws, as well as insurance laws. Similarly, if a licensed real estate professional sells undivided, fractionalized interests in real estate to buyers looking only for a passive, managed investment, he/she should be subject to the securities laws, as well as, real estate laws. However, in a proper instance, where there is no need for dual licenses, appropriate state authority may waive a dual licensing requirement – but the general securities law should never be abated as that impacts investor rights.

4. The Bill is non-uniform and out-of-step with the laws of other states and the federal government which overwhelmingly treat these products as securities. Federal law generally treats TIC interests as securities. The Bill would: a) add additional cost and difficulty to the preparation of Montana properties to be converted to TICs and sold into the national market, b) cause Montana TIC properties to be less valuable as national investors will favor properties from states with uniform laws, greater investor protection and no conflict between state and federal laws, c) put Montana sponsors and sellers at greater risk of violating federal securities laws – which require licensure and adequate disclosure of sales of TIC interests structured as securities, and d) cause other harmful effects to the market both in and outside Montana’s borders.

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Only one other state, Utah has a similar law, and the results of that law are uncertain to this day. The immediate result of the passage of the Utah law, was that the TIC industry stopped consideration of its purchase of Utah property. Tens of millions of dollars in pending TIC deals were held up for months and buyers passed on Utah purchases, and real property owners suffered while lawyers tried to learn whether Utah's real estate was suitable for use in TIC transactions sold outside of Utah. It took many months to straighten out some of the problems caused by Utah's law. The point is that non-uniform laws in this area are harmful to the states which are not uniform. The Bill does nothing to change federal law, and it is out of step with how these products are regulated elsewhere.

The practical outcome of the Bill is that TIC program sponsors will likely choose to do business in other states which follow the uniform laws and which have high standards for investor protection.

Montana TICA members who gave their time and talents to travel to Helena to oppose the Bill included Rick Ahmann, Ray Petersen, Justin Todd and Donovan Kelly.

Lynne Egan, Montana's Deputy Commissioner of Securities, identified herself as an information resource for the House Judiciary Committee, and acknowledged the course of action that both the SEC and the North American Securities Administrators Association (NASAA) were pursuing with respect to a no action letter conferring on licensed real estate professionals in a TIC transaction exempt status from licensing as securities agents.

Bob Lake the Bill's sponsor acknowledged that based upon recent developments, the Bill should be tabled for revision.

BULLETIN:

House Bill (HB) 256 was tabled by Montana's Senate Judiciary committee on Friday, March 30. According to Lynne Egan, Deputy Securities Commissioner in Montana, "It is my understanding that this bill would remain tabled unless someone from the committee specifically requested the matter be reconsidered for a vote or a senator could "blast" the bill directly onto the Senate floor for consideration, but a super-majority is needed to pass the bill in this fashion. While a reconsideration in committee could happen, it is highly unlikely the matter would be "blasted" onto the Senate floor."

OUTLOOK FOR THE FUTURE

Oregon – SB 449: Senator Rick Metsger of the Oregon Legislature has introduced Senate Bill (SB) 449 which is similar to the Montana proposal. The Oregon Bill has been referred to the Senate Business, Transportation and Workforce Development Committee which Senator Metsger chairs. No public hearing has been scheduled yet. TICA has gone on the record in opposition to SB 449.

Idaho: TICA has also learned that similar legislation may be introduced in Idaho by Spectrus, DBSI and the Idaho Association of Realtors. It is our understanding that the Idaho Securities Commission is working cooperatively with its Real Estate Association to draft a potential no-action letter that may allow for the compensation of real estate licensees. TICA will keep you posted on any future developments.

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